

Internal Revenue Service

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Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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CC:CORP:03

PLR-139985-06

Date:

December 20, 2006

Distributing =

Controlled =

Sub 1 =

Sub 2 =

Sub 3 =

State A =

X =

Y =

b =

Date C =

d =

Ratings Agency =

Dear

We respond to your request dated August 18, 2006, for rulings on the Federal income tax consequences of a proposed transaction. Additional information was submitted in a letter dated October 10, 2006. The information submitted for consideration is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This Office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)), and (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and § 1.355-7).

Distributing is a State A, publicly traded, insurance holding company that is the common parent of an affiliated group that files a consolidated Federal income tax return. Distributing is engaged in X line of insurance through its wholly owned subsidiaries, Sub 1, Sub 2, and Sub 3 ("the Distributing Group"). Distributing has one class of common stock outstanding.

Controlled is a State A corporation engaged in the Y line of insurance. Controlled is a wholly owned subsidiary of Distributing. Controlled has one class of common stock outstanding.

Financial information has been received that indicates that the Distributing separate affiliated group (within the meaning of §355(b)(3)(B)) (SAG) and Controlled businesses each have had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

For what are represented to be valid business purposes, the following transaction is proposed:

- (i) Distributing will cause Controlled to adopt a plan of recapitalization. In the recapitalization, Distributing will exchange all of its shares of Controlled stock for a number of shares of Controlled common stock equal to the issued and outstanding shares of common stock of Distributing. Controlled will also authorize and issue to Distributing voting preferred stock. The preferred stock will have one vote per share.
- (ii) Distributing will distribute to its shareholders all of the shares of the Controlled common stock.
- (iii) Distributing will retain all of the shares of Controlled voting preferred stock (the "retained stock"), which will serve as substituted collateral on existing indebtedness. Distributing will pledge the retained stock to the holders of its senior indebtedness. The retained stock represents approximately b percent, which is less than one percent, of the voting power of Controlled.
- (iv) The retained stock will be redeemed no later than Date C.
- (v) The retained stock will be voted in proportion to the votes cast by other shareholders of Controlled, except that the retained stock may be voted separately as a class where the outcome of the vote would alter the capital structure of Controlled to the detriment of the holders of the shares of preferred stock.
- (vi) A Distributing officer will continue to serve as a director of Controlled until his term expires in d.

The following representations have been made in connection with the proposed transaction:

- (a) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Distributing's SAG is representative of the SAG's present operation, and with regard to such SAG, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) The recapitalization of Controlled will constitute a recapitalization within the meaning of §368(a)(1)(E).

(d) Following the transaction, the Distributing SAG and Controlled will each continue the active conduct of its business, independently and with its separate employees except that Controlled may utilize the payroll services of Distributing for a transitional period of no more than six months.

(e) The distribution of the stock of Controlled is carried out for the following corporate business purposes: to protect the business of the Distributing SAG from the potential liabilities arising from the business of Controlled and consequent reduction in its rating by Ratings Agency (risk reduction). The distribution of stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.

(f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(g) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

(h) Immediately before the distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations. Further, Distributing's excess loss account (if any) with respect to the Controlled stock will be included in income immediately before the distribution (see §1.1502-19).

(i) Payments made in connection with all continuing transactions, if any, between the Distributing SAG and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(j) The distribution is not part of a plan or series of related transactions (within the meaning of §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of §355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

Based solely on the information submitted and on the representations set forth above, we hold as follows:

(1) No gain or loss will be recognized by Distributing upon the distribution of its stock in Controlled to its shareholders. Section 355(c)(1).

(2) No gain or loss will be recognized by (and no amount will be included in the income of) Distributing's shareholders on their receipt of Controlled stock. Section 355(a)(1).

(3) The aggregate basis of the Controlled stock and Distributing stock in the hands of the shareholders of Distributing after the distribution will, in each instance, be the same

as the aggregate basis of the shareholders in the Distributing stock immediately before the distribution, allocated in proportion to the fair market value of each in accordance with §1.358-2(a)(2). Section 358(a)(1), (b) and (c).

(4) The holding period of the Controlled stock received by the shareholders of Distributing as a result of the distribution will, in each instance, include the holding period of the Distributing stock with respect to which the Controlled stock was received, provided that such Distributing common stock is held as a capital asset on the date of the distribution. Section 1223(1).

(5) Earnings and profits will be allocated between Distributing and Controlled pursuant to §§312(h), 1.312-10(b), and 1.1502-33(e).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the distribution satisfies the business purpose requirement of §1.355-2(b); (ii) whether the proposed transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see §355(a)(1)(B) and § 1355-2(d)); and (iii) whether the proposed transaction is part of a plan (or series of related transactions) under §355(e)(2)(A)(ii). In addition, no opinion is expressed regarding whether Controlled is considered an insurance company for Federal income tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Ken Cohen
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel (Corporate)